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**Before the**

**Supreme Court of the United States**

**October Term, 1947**

**No. . . . .**

**NATE S. SHAPERO,**

*Petitioner,*

**vs.**

**COMMISSIONER OF INTERNAL REVENUE,**

*Respondent.*

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**Petition for Writ of Certiorari to the United  
States Circuit Court of Appeals for the Sixth  
Circuit and Brief in Support of Petition**

To: The Honorable Chief Justice of the United States and  
Associate Justices of the Supreme Court of the  
United States:

**SUMMARY STATEMENT OF THE  
MATTERS INVOLVED**

This is a petition before the Tax Court to review the action of the Commissioner of Internal Revenue in taxing to petitioner the income for 1940 and 1941 of three trusts created by petitioner as settlor for his wife as beneficiary of one, his son of the second and his daughter of the third. The taxes were levied under Section 22(a) of the Internal Revenue Code and the application of the doctrine of *Helvering vs. Clifford*, 309 U. S. 331. The judge of the Tax Court who presided at the hearing voted in favor of

petitioner—clearly as to the trusts for the son and daughter—and it is inferred from what he wrote, as to the trust for the wife as well (R. 48). Three other judges of the Tax Court joined with him as to the son and daughter (R. 45). The prevailing opinion (of the judges other than the four above referred to) upheld the Commissioner's action as to all three trusts (R. 44).

While the case was pending before the Tax Court the Commissioner promulgated T.D. 5488\* intended to effect substantial certainty in the application of Section 22(a) and the Clifford case doctrine. The Tax Court refused to apply or consider T.D. 5488 (R. 44). This was assigned, among other matters, as error in the petition for review to the Circuit Court of Appeals. That court reviewed the case both independently of and by an application of T.D. 5488—the latter at the insistence of both parties. The position of petitioner was and is that T.D. 5488 must be applied and consideration of the case on any other basis is immaterial.

The record made before the Tax Court consists wholly of writings and testimony of petitioner and of two officers of the corporate trustee. There is no conflict in the testimony or other evidence nor established facts from which divers inferences can be drawn. The questions are of law only—what of the established facts are the controlling facts and what the effect in law is of such controlling facts.

The trusts were created December 6, 1934, each by a separate writing and each was amended December 29, 1936. The Commissioner taxed to petitioner the income for 1935 and 1936. This action was taken to the Board of Tax Ap-

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\*Printed *infra* 32-43.

peals in Docket No. 96982. Decision was entered July 11, 1939, on Stipulation—the income was not taxed to petitioner.

The son and daughter were minors at the time the trusts were created—the son eight years of age and the daughter four years of age. The final distribution under each of the children's trusts is to be made when the child attains the age of forty-five (45) years. The trust for the wife continues throughout life. There are two trustees—Detroit Trust Company and petitioner. The testimony of the officers of the corporate trustee indicates that they had functioned in their normal and usual manner of acting in the administration of trusts (R. 80-82). Petitioner, as individual trustee, possesses no power which does not pass to a successor and may ultimately pass to the corporate trustee. Petitioner does, however, have power to remove the corporate trustee.

Petitioner, as grantor, reserved to himself but one power, namely, a limited power to amend, i. e., expressly restricted against any amendment which would—

"change or impair the right of enjoyment of any beneficiary"

or

"vest in himself title to any part of the corpus or income." (Par. 1, *infra* 44.)

The individual trustee is by the trust instrument given very broad powers of administrative control. These powers are now in petitioner. It is expressly provided that these powers shall pass without diminution to any successor individual trustee. The trust as to the daughter was to

continue for forty-one (41) years. That for the wife for her lifetime. There was thus a long period of time to be looked forward through and all possible contingencies provided for. The Tax Court summarized the powers (R. 31) as follows:

"He held as trustee 'the fullest possible latitude in making investments,' the discretionary right to manage all the trust properties, the unlimited power to vote all trust stocks or to direct the manner in which they should be voted, 'absolute and uncontrolled discretion' to determine the expediency and propriety of selling, mortgaging, or otherwise disposing of all trust property, 'at such time or times and in such manner, either public or private, and upon such terms' as he thought fit, the right to distribute in kind trust securities selected by him and to make a 'final and conclusive' determination of the proportions and prices at which such distributions should be made, the privilege of joining with security holders in voting trusts, reorganizations and refinancing arrangements and to deposit trust stocks for that purpose, the 'complete and absolute power \*\*\* to direct the payment and conveyance \*\*\* of any part or all of the principal of the trust property \*\* as well as any accumulated income therefrom, to the then living beneficiary or beneficiaries thereof, in such proportions [as petitioner] may think proper,' and the fullest and most complete powers and authority which it is possible for grantor to give in respect of all sales, investments, expenditures, management and control of the trust property and estate; \*\*\*'."

Many of these powers were not exercisable during the tax years here in question. That is true of practically all set forth on lines 10-13, 17-22 above. Any power in relation to distribution cannot be exercised until the time for dis-

tribution has arrived many years hence—not improbably by a successor trustee. The power to direct payment and conveyance of principal and accumulated income did not give power to choose among beneficiaries, as there is only one beneficiary of each trust—though there might be more than one beneficiary at some time within the forty-one (41) years if the son or daughter should die leaving two or more children. The power to join in reorganizations, etc., is a highly desirable power in any trust intended to hold corporate stock—a draftsman who did not put it in would not be best discharging his duty.

As to the other powers mentioned in the above quoted excerpt from the opinion of the Tax Court in particular and all powers mentioned in said excerpt in general, each and all fall within one or more of the permitted specifications of T.D. 5488 (as shown in the brief appended hereto). The Court of Appeals in its opinion said—"the attorney for petitioner treats separately with each of the subdivisions of the amended regulations and urges that under all the instant trusts pass every test of non-taxability to the grantor" (R. 103). The court then proceeded to consider all powers on an over-all basis and applied the pre-T.D. 5488 test of broad administrative control. This is precisely what T.D. 5488 was designed to eliminate from the consideration and determination of trust cases under Section 22(a). Under T.D. 5488 if the several powers retained separately pass the separate specifications of the T.D. no combination or aggregation thereof was intended to produce a different result. This is argued at length in the appended brief in support of this petition.

The other powers mentioned in the above quoted excerpt (if they were to be considered independently of T.D. 5488

which said T.D. intends they shall not) resolve themselves down to this—can the head of a family who has been successful in business establish trusts for the several members of his family to protect them against the hazards of business and also give to them in a fiduciary capacity in the administration of such trusts the benefit of his skill, experience, zeal and zest without running afoul of the doctrine of *Helvering vs. Clifford*, as declared by this court? Here there is not the slightest question in the record that these trusts have not been at all times administered in a fiduciary manner in accordance with normal practice (the officers of the corporate trustee so testified) solely for the benefit of the beneficiaries and without petitioner deriving any economic or business benefit from the administration. He did not need the votes of the trust shares at the Cunningham Drug Stores, Incorporated, meetings in the years in question. What petitioner got out of it and all he got out of it was the satisfaction of knowing the future of his family was being well and safely provided for. That may or may not be wrong or draw to itself tax consequences. It ought to be encouraged, not penalized.

The Court of Appeals said that under the power to amend, petitioner might have provided for making of "loans to himself primarily for his own benefit" (R. 107). But the Trust Instrument says that the power to amend shall not be exercised in a manner which would impair the right of enjoyment of any beneficiary. Since when in the law of trusts has it been deemed consistent with the interests of a beneficiary that a trustee might loan to himself? T.D. 5488 goes so far beyond the law of trusts as to permit loans to a trustee if adequate interest or security is given (*infra* 41 (2)). Certainly loans out of a trust fund to the settlor of the trust established to protect against the

hazards of settlor's business whereby the moneys loaned to the settlor come back under the hazards of that business are utterly inconsistent with the purposes of the trust and in contravention of the intent and the attempt to accomplish the same indirectly through exercise of a power to amend, limited as above stated, is not permissible in law.

Each of the trusts holds shares of Cunningham Drug Stores, Incorporated, a retail drug store chain in Detroit. The wife's trust originally contained 20,000 shares, but 10,300 shares were sold in 1937 and the proceeds invested in other stocks and securities. Each child's trust had 672 shares at the beginning. This has been gradually built up so that in the tax years in question each child's trust had 7,092 shares. The children's trusts also have other stocks and securities (R. 27). The business now conducted by Cunningham Drug Stores, Incorporated, was begun by petitioner in 1918 as a sole proprietorship. Petitioner has always been president and director of the corporation. The total shares owned by petitioner, his wife and children and said three trusts is short of one-third (1/3) of the total outstanding.\* At the annual meetings in the tax years here in question the Shapero interests, including the trusts, voted in one year a fraction under and in another year a fraction over sixty per cent (60%) of the shares present at the meeting (R. 27). If the trust shares had not been represented at either meeting, petitioner, his family and his associates in the management would still have voted a majority of the shares at each meeting.\*

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\*Readily calculable from Exhibit 7, prepared by the Revenue Agent—not printed.

The trust instruments were not printed in the record before the Court of Appeals. The paragraphs to which reference is made in this petition or the accompanying brief are reproduced in the appendix hereto, infra 44-50. T.D. 5488 is also printed, infra 32-43, exactly as it was printed as an appendix to Respondent's Brief before the Court of Appeals.

### **JURISDICTIONAL STATEMENT**

It is contended that the Supreme Court has jurisdiction to review the judgment here in question because review is sought of a judgment of a Circuit Court of Appeals affirming a decision of the Tax Court of the United States affirming the levying by the Commissioner of Internal Revenue of an income tax under Section 22(a) of the Internal Revenue Code and this court has jurisdiction to review by certiorari under 28 U. S. Code, Section 367(a).

### **QUESTIONS PRESENTED**

1. In determining under T.D. 5488 the taxability to the settlor of the income of a trust under Section 22(a) of the Internal Revenue Code did not the Circuit Court of Appeals err in basing its decision on a "bundle of rights" view of all powers of the settlor-trustee when the T.D. expressly provides that the existence of each of such powers shall not be "factors" of such control as to make the income taxable to the settlor-trustee?

2. Does not each of the instant trusts pass every test of non-taxability to the settlor under each of the subdivisions of T.D. 5488 treated separately and therefore did not the Circuit Court of Appeals err in holding the income of each trust taxable to the settlor notwithstanding?
3. Where the settlor's reserved powers of amendment are limited to such as will not "change or impair the right of enjoyment of any beneficiary" did not the Circuit Court of Appeals err in holding that the settlor might make an amendment "primarily for his own benefit" and that thereby the income is taxable to the settlor?
4. Is the holding by the trustees of stock in a corporation of which the settlor is founder, director and president, a factor of weight where the total shares held by the settlor, the members of his family and the trusts was less than one-third (1/3) of the total shares outstanding and the settlor, the members of his family and his associates in the management if the trust shares had not been represented at the annual meetings in the tax years in question, would have had a majority of the shares present?

### **REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT**

Two reasons stated in Rule 38 are relied upon. The Circuit Court of Appeals for the Sixth Circuit in the instant case has:

- (a) decided an important question of Federal Law which has not been but should be settled by this court.
- (b) rendered a decision in conflict with the decision of another Circuit Court of Appeals on the same matter.

#### **Reason (a)**

T.D. 5488 was promulgated while this case was before the Tax Court and before the final submission of the case in that court. The purpose of the T.D. is in the "introduction" thereof (*infra* 33) stated to be—

"In the absence of precise guides supplied by an appropriate regulation, the application of this principle to varying and diversified factual situations has led to considerable uncertainty and confusion. The provisions of this section accordingly resolve the present difficulties of application by defining and specifying those factors which demonstrate the retention by the grantor of such complete control of the trust that he is taxable on the income therefrom under Section 22(a)."

The Tax Court declined to apply the T.D. at all citing (R. 44) its prior action in the case of *Louis Stockstrom*, 7 Tax Court 251, in which case the Tax Court declined to

consider the T.D. notwithstanding the order of the Circuit Court of Appeals for the Eighth Circuit\* sending the case back that the T.D. might be considered. With this situation before it the Circuit Court of Appeals for the Sixth Circuit in the instant case proceeded at the instance of counsel for both parties to itself consider and apply the T.D. in the first instance. Petitioner insists that error was committed in the manner of so doing although question is not raised as to the propriety of proceeding without precedent action of the Tax Court. Thus an entirely new and different situation is here presented by reason of T.D. 5488 in the application of Section 22(a) of the Internal Revenue Code to trust income under the doctrine of the *Clifford* case and in the relation of the Tax Court and Circuit Court of Appeals to the application of the T.D.

#### **Reason (b)**

It is understood "the same matter" as used in the rule means not between the same parties but of the same nature. In the instant case the Circuit Court of Appeals referred (R. 108 top) to *Cushman vs. Commissioner*, 153 Fed. (2d) 510, in the Second Circuit, which had been pressed by petitioner in the instant case as applicable and had been followed by the First Circuit in *U. S. vs. Morss*, 159 Fed. (2d) 142, and the Tax Court in *Welch vs. Commissioner*, 8 T.C. 1139. After such reference to the *Cushman* case the Circuit Court of Appeals in the instant case said, "We are in accord with the dissent." (R. 108, line 7.) The decision was largely predicated upon such accord.

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\*Set out in Tax Court Opinion, 7 T.C. 252 but not referred to in C.C.A. Opinion, 148 Fed. (2d) 491.

WHEREFORE, your petitioner prays that a writ of certiorari issue under the seal of this court directed to the Circuit Court of Appeals for the Sixth Circuit commanding said court to certify and send to this court a full and complete transcript of the record and of the proceedings of said Circuit Court of Appeals had in the case numbered and entitled on its Docket as No. 10516, Nate S. Shapero, Petitioner, vs. Commissioner of Internal Revenue, Respondent, to the end that this cause may be reviewed and determined by this court as provided for by the statutes of the United States and that the judgment herein of said Circuit Court of Appeals be reversed by this court and for such further relief as to this court may seem proper.

Dated at Detroit, Michigan, April 30, 1948.

THOMAS G. LONG,  
*Counsel for Petitioner.*  
1881 National Bank Bldg.  
Detroit 26, Michigan

Before the

**Supreme Court of the United States**

**October Term, 1947**

No. ....

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NATE S. SHAPERO,

*Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*

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**BRIEF IN SUPPORT OF PETITION  
FOR CERTIORARI**

**OPINION OF COURTS BELOW**

The opinion in the Circuit Court of Appeals was rendered February 3, 1948, and is reported 165 F. (2d) 811. It is printed (R. 99). The opinion in the Tax Court is reported 8 T.C. 104 and is printed (R. 45).

**JURISDICTION**

1. The date of the judgment to be reviewed is February 3, 1948 (R. 98).
2. The statutory provision which is believed to sustain the jurisdiction of this court is 28 U. S. Code, Section 367 (a).
3. The case is a petition to the Tax Court by a taxpayer to review the levying by the Commissioner of Internal Revenue of income tax against taxpayer as settlor of a

trust of the income accruing to such trust. The decision of the Tax Court upheld the levying of the tax (R. 49). The taxpayer petitioned for review by the Circuit Court of Appeals and that court affirmed the Tax Court (R. 98).

4. So far as concerns the question of jurisdiction, this being the ordinary case and method for review of the levying of an income tax, citation of cases is deemed superfluous.

#### **STATEMENT OF THE CASE**

This has already been stated in the preceding petition (*supra*, pages 1 to 7) which is hereby adopted and made a part of this brief.

#### **SPECIFICATION OF ERRORS**

The errors in the opinion and judgment of the Circuit Court of Appeals which are relied upon by petitioner are set out in the Statement of "Questions Presented" in the accompanying petition for writ of certiorari (*supra* 8-9). Petitioner relies upon and will urge before this court all of the errors therein assigned.

#### **ARGUMENT**

It is understood that the argument should be confined to a discussion of the issue whether certiorari should or should not be granted and should not extend to an argument on the merits of the questions presented. Effort is

therefore being made to so confine the argument being made herein, but in view of T.D. 5488 being so recent it is thought not out of order to acquaint the court somewhat with the contents thereof and show the application thereof by particular reference to the instant case. It requires but a few pages to do so.

#### **SUMMARY OF THE ARGUMENT**

A. Every taxpayer is entitled to equal treatment in the application of T.D. 5488 and that application must be by laying each provision of the trust instrument against the particular provision of the T.D. dealing with the subject-matter of such provision of the trust instrument, and if such provision of the trust instrument passes the test of such provision of the T.D. such provision of the trust instrument is thereby excluded as a factor in determining whether the settlor "has retained control of the trust so completely that he is still in practical effect the owner of its income." (Quoted from T.D. infra 33.)

B. A reserved power of amendment is of no legal consequence where it is limited to such as will not "change or impair the right of enjoyment of any beneficiary" and with such limitation cannot be exercised primarily for the benefit of the settlor.

C. The holding in a trust of stock in a corporation of which the settlor is founder, director and president is of no legal consequence where it is not needed to give the settlor practical control of the corporation and is not sufficient to give the settlor alone majority control.

**POINT A****Manner of Application of T.D. 5488—Over all or each Specification Separately.**

The T.D. is printed in full, infra 33.

Mimeograph 5968, which accompanied T.D. 5488 in Internal Revenue Bulletin No. 2 of 1946, dated January 28, 1946, stated:

"The Treasury decision provides that Section 22(a) of the Code shall be applied in determining the taxability of trust income for taxable years beginning prior to January 1, 1946, without reference to the amendment to the regulations made by the Treasury decision. However, in cases not yet finally determined for such taxable years, it will be the policy of the Bureau, where no inconsistent claims prejudicial to the Government are asserted by trustees or beneficiaries, not to assert liability of the grantor under the general provisions of Section 22(a) of the Code, if the trust income would not be taxable to the grantor under the amendment to the regulations."

The instant case had not been tried and decided by the Tax Court before T.D. 5488 was issued.

In the findings of the Tax Court in the instant case it appears that consents as required by law have been filed by petitioner as grantor and the trustees (R. 29).

The "Introduction" of the T.D. states that the application of the principle of *Helvering vs. Clifford* "to varying and diversified factual situations has led to considerable uncertainty and confusion" (infra 33). The principle is based upon—if it is not itself—the "bundle of rights" theory. The purpose of the T.D. is therein stated to be "defining and specifying those factors." The T.D. then proceeds to set forth (a) factors the presence of which will not be basis for tax and (b) other factors the presence of which will be such basis. The whole purpose was to do away with the "bundle of rights" application so that no combination of (a) factors, howsoever numerous, will have any other effect than any one or more separately. The Circuit Court of Appeals, however, proceeded in the same old way and in a practical sense disregarded the T.D. That the T.D. was intended to and does have an important effect on these cases is well illustrated by the course of the case of *Louis Stockstrom*, 3 T.C. 255, 148 Fed. (2d) 491, 326 U. S. 719 and on remand 7 T.C. 251. In this case the Tax Court before T.D. 5488 held against the taxpayer which was affirmed on appeal. The T.D. having been promulgated in the meantime the Circuit Court of Appeals made an order for consideration of the T.D. in its application to the case. The order is set forth 7 T.C. 252. The ultimate outcome was stated in the Brief for Respondent before the Circuit Court of Appeals in the instant case—"The Stockstrom case was eventually settled so as not to tax to the grantor the income from the seven trusts for the grandchildren. This adjustment was made in the light of the amended regulation." Argument of the instant case on the merits will show that the trustee (settlor) in the instant case had no broader—if as broad—powers as the trustee (settlor) in the grandchildren's trusts in the Stockstrom case.

The attention and comment which the opinion of the Circuit Court of Appeals in the instant case since being published has evoked in the several tax services indicates that it is regarded as involving something different from what has been heretofore passed upon and noteworthy in the law of trust taxation. It is believed this is the first case to be presented to this court under the scheme or plan which T.D. 5488 was promulgated to put into effect. In view of the difficulties in administration heretofore experienced (including the great number of cases which have come before the Tax Court and Circuit Courts of Appeals on review) which motivated the making of the T.D. the matter presented by the instant case is of great public import. Not until this court has considered the matter and spoken authoritatively thereon will the position and effect of T.D. 5488 in the scheme of trust taxation be known with any substantial certainty. Only in that way can it be known whether the troublesome problems of interpretation and administration which followed the decision in *Helvering vs. Clifford* have been put at rest by the T.D. or whether the only effect of the T.D. has been to present additional equally provoking problems to be dealt with in the same old way.

T.D. 5488 was amended by T.D. 5567 as set forth in Internal Revenue Bulletin No. 14, 1947, dated July 14, 1947. This was accompanied by Mimeograph 6156 set forth on page 6 of the last above mentioned Internal Revenue Bulletin. The first paragraph of the mimeograph is substantially the same as the above quoted excerpt from Mimeograph 5968. The discussion herein is of T.D. 5488 as so amended.

This T.D. provides (*infra* 33) that income of a trust is attributable to the grantor if:

- “(1) The corpus or the income therefrom will or may return after a relatively short term of years \* \* \*;
- “(2) The beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition \* \* \* exercisable by the grantor or another person lacking a substantial adverse interest in such disposition \* \* \*;
- “(3) The corpus or the income therefrom is subject to administrative control, exercisable primarily for the benefit of the grantor \* \* \*.”

Each of these subdivisions will be separately considered.

**(1) Reversionary interest after a relatively short term.**

Paragraph (c) of Section 29.22 of amended regulations 111 covers short-term trusts (*infra* 34). It provides “a relatively short term of years” to be within 10 years from the creation of the trust or within 15 years where there is power to vote stock or control investments. If the trust is based upon a life and the expectancy is less than the years above stated, that is treated as the practical equivalent of being stated directly in such years.

The instant case does not involve trusts for a term of years, but instead covers permanent divestment of both corpus and income on the part of the grantor. Obviously, therefore, this point is not applicable.

**(2) Power to determine or control beneficial enjoyment of income or corpus.**

This point is covered by paragraph (d) of the regulations (infra 36) and provides that the income of a trust is taxable to the grantor, regardless of its duration, where the grantor in any capacity, or any person not having a substantial adverse interest in the beneficial enjoyment of the corpus or income, has the power to vary the interests of the beneficiaries of the trusts whether the interest be in corpus or in income.

In both of the courts below counsel for the Commissioner agreed that the grantor under these trusts could not change the amounts eventually going to the respective beneficiaries. The trusts specifically provide that the grantor cannot "change or impair" the "beneficial enjoyment" of the interests of the beneficiaries (infra 36).

The regulations set forth a series of five excepted powers which will not be classified as powers to determine or control beneficial enjoyment of income or corpus with resultant taxability to the grantor. These will each be briefly considered.

*Power exercisable by Will:* Such a power results in taxability to the grantor only where the income of the trust may be appointed by the grantor in his will, and such income is or may be accumulated in the discretion of the grantor. Since in the instant case the grantor has reserved no powers exercisable by will, this provision obviously does not apply (infra 37 (1)).

*Powers in trust for charity:* The second excepted power is one to determine the beneficial enjoyment of corpus or income if such corpus or income is irrevocably payable to or for charity as defined in Section 23 (o). This is not applicable to the instant case since no charitable provisions are involved (*infra* 37 (2)).

*Powers exercisable by independent trustees:* The third excepted power is a power to (a) distribute or accumulate income, or (b) pay out corpus, but exercisable by trustees none of whom is the grantor. Inasmuch as one of the trustees in the trusts under consideration is the grantor, this provision does not apply (*infra* 37 (3)).

*Powers exercisable by grantor and related persons:* The fourth classification (*infra* 38) deals with excepted powers to distribute or accumulate income or pay corpus, held by—

- (i) the grantor, whether or not as trustee, or
- (ii) trustees who are related to the grantor, or
- (iii) persons other than trustees, or
- (iv) trustees whose exercise of power is subject to the consent of any person not a trustee or the grantor or living spouse, if trustee.

A power held by any of the above is not deemed to represent beneficial enjoyment with respect to corpus if it represents a power to pay corpus but (aa) such power is limited by reasonably definite external standards or (bb) if not so limited, then if it is a power to pay out corpus to a current income beneficiary and such corpus is chargeable against the portion of the corpus from which the respective beneficiaries' income is derived (*infra* 39).

If such power represents distribution or accumulation of income for a current income beneficiary, it is exempt if (cc) the accumulations must ultimately be payable to such beneficiary; or if payable upon termination of the trust or in conjunction with a distribution of corpus which distribution is augmented by such accumulated income, it is ultimately payable to such beneficiary in the share which has been irrevocably specified in the trust. This applies even where the beneficiary does not survive the distribution date (if such date is reasonably within his expected lifetime), if his share goes by appointment of the beneficiary or to designated alternate takers (exclusive of the grantor) in shares specified in the trust (infra 39).

A power covering distributions or accumulations of income or its additions to corpus, exercisable only during the beneficiary's legal disability or minority, is also exempt.

Reference to the instruments here involved shows that both the wife's and the children's trusts come within this fourth excepted classification.

As to the wife's trust, paragraph 2 of the agreement provides that the disbursement of income is to be made by the individual trustee "at such time and in such amounts as the individual trustee shall direct" (infra 50). This, however, does not authorize more than a temporary withholding of income distributions, for this paragraph further provides (infra 50) that "the trustees *shall* distribute the *entire* net income \* \* \* to grantor's wife." Since the accumulated income must ultimately be paid to the wife who is the beneficiary from whom the distribution was withheld, the exception referred to above specifically applies.

Furthermore, paragraph 3 of the wife's trust provides that in case of her death the children take in designated proportions. If the children do not survive, then alternate takers are specified. Thus, the accumulated undistributed income comes within the above quoted exception, even if it were not ultimately payable to the wife, since such accumulated income "shall be considered so payable (to the wife) although it is provided that if any beneficiary does not survive a date of distribution \* \* \*, the share of such deceased beneficiary \* \* \* is to be paid to one or more designated alternate takers \* \* \*." Under the provisions of this trust, no part of the corpus or accumulated income can be paid to the grantor or the grantor's estate.

As respects the children's trusts, the above quoted exception specifically applies because:

- (1) Paragraph 2 of the trusts provides that the income is accumulated during minority (*infra* 44).
- (2) Paragraphs 3 and 14 of the trusts provide that any accumulated income not currently distributed must be paid to them upon the complete termination of the trusts, or when specified portions of the corpus become distributable (*infra* 45 and 49).
- (3) Paragraphs 4 and 5 of the trusts provide that if the children do not survive, then the corpus, together with the accumulated income, is payable to designated ultimate takers other than the grantor or the grantor's estate (*infra* 45-49).

The excepted power of the fourth classification covering payments out of corpus to a current income beneficiary, provided that the payments are chargeable against the proportionate share of corpus held in trust for the pay-

ment of income to such beneficiary as if the corpus constituted a separate trust, clearly applies to both the wife's and the children's trusts (R. 39 (bb)).

As respects the wife's trust, any payment out of corpus automatically is charged against the corpus held in trust for the payment of income to her since she is the only life beneficiary.

In so far as the children's trusts are concerned, they are, under each of the respective trusts, both income and corpus beneficiaries, so that any corpus distributions necessarily come out of their own shares of the corpus of the trusts.

### (3) **Administrative control.**

Paragraph (e) of the amended regulations imposes a tax on the grantor on income of a trust where the grantor's administrative control "is exercisable primarily for the benefit of the grantor rather than for the beneficiaries of the trust." (infra 40.)

The regulations provide that administrative control is exercisable primarily for the benefit of the grantor where the grantor or any person is enabled

"(1) \* \* \* to purchase, exchange, or otherwise deal with or dispose of the corpus or the income therefrom for less than an adequate and full consideration in money or money's worth (infra 41); or

"(2) \* \* \* to borrow the corpus or income directly or indirectly, without adequate interest \* \* \* or \* \* \* security (infra 41); or

"(3) \* \* \* has directly or indirectly borrowed the corpus or income and has not completely repaid the loan, including any interest before the beginning of the taxable year (infra 41); or

"(4) any one of the following powers of administration over the trust corpus or income is exercisable by any person in a *non-fiduciary* capacity:

- a power to vote or direct the voting of stock or other securities;
- a power to control the investment of the trust funds either by directing investments or reinvestments or by vetoing proposed investments or reinvestments;
- a power to reacquire the trust corpus by substituting other property of an equivalent value.

It is clear that the instant trusts do not fall within the admonitions of the administrative control provisions of subparagraph (e) of the regulations. *None* of the powers "are exercisable in other than a fiduciary capacity primarily in the interests of the beneficiaries." Every one of the administrative powers that the grantor possessed under the trusts were powers as *trustee*. Every one of such powers pass to a successor individual trustee and may become exercisable by the corporate trustee alone. There is no power to purchase for less than full and adequate consideration nor power to borrow or reacquire under any circumstances and the powers to vote and control investments are strictly as a fiduciary.

Attention is here directed to the following provisions of the regulations under paragraph (e) (infra 42):

"If a power is exercisable by a person as trustee it is presumed that the power is exercisable in a

fiduciary capacity primarily in the interests of the beneficiaries. Such presumption may be rebutted only by clear and convincing proof that the power is not exercisable primarily in the interests of the beneficiaries."

The regulations then state in this connection as follows:

"The mere fact that a power exercisable by the trustee is described in broad language does not indicate that the trustee is authorized to purchase, exchange, or otherwise deal with or dispose of the trust property or income for less than an adequate and full consideration in money or money's worth or is authorized to lend the trust property or income to the grantor without adequate interest. On the other hand, such authority may be indicated by the actual administration of the trust."

With respect to the actual administration of the trust, attention is directed to the Tax Court's findings of fact (R. 28).

There can be no question but that these trusts have been administered not only "primarily" but "exclusively" in the interests of the beneficiaries. The reserved administrative powers in the trusts were for the benefit, and only for the benefit, of the beneficiaries.

**POINT B****The Limited Power to Amend—Can it be Exercised  
Primarily for the Benefit of the Settlor?**

It becomes necessary to discuss this point because however clearly a trust in its terms as written and in its administration as conducted passes the tests of T.D. 5488, if the settlor has power of amendment under which he might change provisions so that the same would contravene the provisions of T.D. 5488, the present passing of the tests would be of no avail.

The respondent's brief in the Circuit Court of Appeals in effect said that but for paragraph 1 of the Trust Instrument reserving a limited power to amend, the petitioner would not be taxable under the regulation. The power under paragraph 1 of the Trust Instrument in the way it is limited so as not "to change or impair the right of enjoyment of any beneficiary" is in law a fiduciary power and not exercisable to use the words of the court in *Cushman vs. Commissioner*, 153 Fed. (2d) 510, "contrary to the best interests of the beneficiary."

It was so held in that case in respect of power "to control retention or sale of the trust property and to direct investment and reinvestment of the trust funds." The discussion in the Cushman case, page 514 [points 7-10] as to when power in the settlor as settlor (as distinguished from trustee powers) are fiduciary powers is most cogent. It is, among other things, said:

"Ordinarily they are held in a fiduciary capacity, and have been reserved only because of some special

talent or particular source of knowledge of the grantor."

This power under paragraph 1 of the instant trusts is limited in that it cannot be so exercised as "to change or impair the right of enjoyment of any beneficiary" (infra 44).

It was said in the brief for respondent below that an amendment might be made which would permit the grantor to provide that the trust funds should be loaned to him with or without security or interest whenever he should request such a loan. A power to amend to such extent would, under paragraph (e) subparagraph (2) of the regulations (infra 41), make the income taxable to the settlor. Under the above limitation in the Trust Instrument, however, a loan could not be made "without security or interest" for that would "impair the right of enjoyment of any beneficiary." A loan "without adequate interest" would in any case impair the right of the beneficiary for it is the right of the beneficiary of a trust that the trust property shall be managed so as to produce adequate income.

Under paragraph (e) subparagraph (3) of the regulation (infra 41), power to make a loan to the grantor is *permitted* and whether or not there is any tax effect depends wholly on whether there is in fact a loan outstanding at any time during the tax year.

Under paragraph (e) subparagraph (1) of the regulation (infra 41), even a power "to purchase, exchange or otherwise deal with" the trust property is permissible so

long as it cannot be done without "an adequate and full consideration in money or money's worth." Thus if petitioner undertook to exercise the reservation of power to amend in paragraph 1, to authorize a purchase or exchange by himself whereby all the Cunningham stock would be taken out of the trust this would be permissible under the regulation if provided to be done for "an adequate consideration in money or money's worth." If not so provided it would impair the right of enjoyment of the beneficiary and thus not be within the power to amend.

See generally the provisions of said T.D. set forth which comment on and give illustrations of the application of the specific subparagraphs of the regulation.

If petitioner, as grantor of said trust, in the exercise of said power to amend under paragraph 1 of the trust instrument, were to undertake to strike out the provision in paragraph 2 which restricts the paying out of income for the benefit of a child to some way "which the grantor as parent of said minor is not under obligation in law to provide" and/or were to undertake to provide for the use of the income of the trust to satisfy such obligation in law of the grantor as parent, that again would impair the right of enjoyment of the beneficiary because the minor is presently entitled to the income of the trust in addition to or free of such legal obligation of the grantor as parent.

And in any event under Section 167 (c) of the Internal Revenue Code even if a trust provides for the use of income "for the support or maintenance of a beneficiary whom the grantor is legally obligated to support or maintain" nevertheless the income is not taxable to the grantor "except to the extent that such income *is so applied.*"

Section 134 (b) (2) of the Revenue Act of 1943 must also be complied with. But in the instant case there was no occasion to do this because the trust instrument did not in the tax years here in question in fact provide for such use of income but provided against such use.

#### POINT C

##### **The Stock Held by the Trust in the Corporation of Which Settlor Is Founder, Director and President Is Not Sufficient for Legal Control and Is Not Required for Practical Control.**

This point is dealt with because so much has been made of trusts holding stock in corporations in which the settlor has a management interest. In many of the trusts which have come before the Tax Court (and some on review) an incidental or collateral purpose of the trust has been to confirm the settlor in his position in the corporation. And that has been a strong factor in holding the income taxable to the settlor. But here the wife's trust in the tax years in question had less than one-half of the shares of the corporation which were transferred to the trust at its inception. More than one-half had been sold and the proceeds invested in securities of other corporations. The total shares held by the settlor, the members of his family and the trusts was less than one-third of the outstanding shares of the corporation. While the shares so held constituted sixty per cent in round figures of the shares present at the annual meetings in the tax years in question, nevertheless, if the trust shares had not been represented at the meetings settlor, the members of his family and his associates in the management would still have had a majority of the shares present or represented.

IT IS THEREFORE RESPECTFULLY SUBMITTED, that this case is one calling for the exercise by this court of its supervisory powers by granting a writ of certiorari and thereafter reviewing and reversing said decision.

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**APPENDIX**

**Internal Revenue Code:**

**SEC. 22. GROSS INCOME.**

(a) *General definition.*—“Gross income” includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. \* \* \*

(26 U. S. C. 1940 ed., Sec. 22.)

**Treasury Regulations 103, promulgated under the Internal Revenue Code:**

SEC. 19.22 (a)—1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include the profit gained through a sale or conversion of capital assets. \* \* \*

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.22 (a)—21 [as added by T.D. 5488, 1946—1 Cum. Bull. 19, and amended by T.D. 5567, 1947—14 Int. Rev. Bull. 2]. TRUST INCOME TAXABLE TO THE GRANTOR AS SUBSTANTIAL OWNER THEREOF.—(a) *Introduction.*—Income of a trust is taxable to the grantor under section 22 (a) although not payable to the grantor himself and not to be applied in satisfaction of his legal obligations if he has retained a control of the trust so complete that he is still in practical effect the owner of its income. (*Helvering vs. Clifford*, 309 U. S. 331.) In the absence of precise guides supplied by an appropriate regulation, the application of this principle to varying and diversified factual situations has led to considerable uncertainty and confusion. The provisions of this section accordingly resolve the present difficulties of application by defining and specifying those factors which demonstrate the retention by the grantor of such complete control of the trust that he is taxable on the income therefrom under Section 22 (a). Such factors are set forth in general in paragraph (b) and in detail in paragraphs (c), (d), and (e), below.

(b) *In general.*—In conformity with the principle stated in paragraph (a) above, the income of a trust is attributable to the grantor (except where such income is taxable to the grantor's spouse or former spouse under Section 22 (k) or 171) if—

- (1) the corpus or the income therefrom will or may return after a relatively short term of years (see paragraph (c));
- (2) the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition (other than certain excepted powers), whether by revocation, alteration, or otherwise, exercisable

by the grantor, or another person lacking a substantial adverse interest in such disposition, or both (see paragraph (d)); or

(3) the corpus or the income therefrom is subject to administrative control, exercisable primarily for the benefit of the grantor (see paragraph (e)).

(c) *Reversionary interest after a relatively short term.*—Income of a trust is taxable to the grantor where the grantor has a reversionary interest in the corpus or the income therefrom which will or may reasonably be expected to take effect in possession or enjoyment—

(1) within 10 years commencing with the date of the transfer, or

(2) within 15 years commencing with the date of the transfer if the income is or may be payable to a beneficiary other than a donee described in Section 23 (o) and if any one or more of the following powers of administration over the trust corpus or income are exercisable solely by the grantor, or spouse (living with the grantor, and not having a substantial adverse interest in the corpus or income of the trust), or both, whether or not exercisable as trustee: a power to vote or direct the voting of stock or other securities, a power to control the investment of the trust funds either by directing investments or reinvestments or by vetoing proposed investments or reinvestments, and a power to reacquire the trust corpus by substituting other property, whether or not of an equivalent value.

Where the grantor's reversionary interest is to take effect in possession or enjoyment by reason of some event other than the expiration of a specific term of years, the trust income is nevertheless attributable to him if such event is the practical equivalent of the expiration of a period less than 10 or 15 years, as the case may be. For example, a

grantor is taxable on the income of a trust if the corpus is to return to him or his estate on the graduation from college or prior death of his son, who is 18 years of age at the date of the transfer in trust. Trust income is, however, not attributable to the grantor where such reversionary interest is to take effect in possession or enjoyment at the death of the person or persons to whom the income is payable.

In general, a reversionary interest may reasonably be expected to take effect in possession or enjoyment within 10 or 15 years, as the case may be, where the corpus or the income therefrom is to be reacquired if the grantor survives any stated contingency which is of an insubstantial character. Thus, the grantor is taxable where the trust income is to be paid to the grantor's wife for three years, and the corpus is then to be returned to the grantor if he survives such period, or to be paid to the grantor's wife if he is already deceased.

Any postponement of the date specified for the reacquisition of possession or enjoyment of the reversionary interest is considered a new transfer in trust commencing with the date on which the postponement is effected and terminating with the date prescribed by the postponement. But income for any period shall not be taxable to the grantor by reason of the preceding sentence if such income would not be taxable to him in the absence of such postponement.

*Example.* A places property in trust for the benefit of his son B. Upon the expiration of 12 years or the earlier death of B the property is to be paid over to A or his estate. Neither A nor his wife has any power of administration over the trust corpus or income. After the expiration of nine years A extends the term of the trust for an additional two years. A is considered to have made a new transfer in trust for a term of five years. He is not taxable on the

income for the first three years of such term because he would not be taxable thereon if the term of the trust had not been extended. A is taxable, however, on the income for the remaining two years.

(d) *Power to determine or control beneficial enjoyment of income or corpus.*—Income of a trust is taxable to the grantor where, whatever the duration of the trust, the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition (except as provided in Section 167 (c) and as hereafter provided in subparagraphs (1) to (4), inclusive), whether by revocation, alteration, or otherwise, exercisable (in any capacity and regardless of whether such exercise is subject to a precedent giving of notice or is limited to some future date) by the grantor, or any person not having a substantial adverse interest in the beneficial enjoyment of the corpus or income, whichever is subject to the power, or both. The grantor is not taxable, however, if the power, whether exercisable with respect to corpus or income, may only affect the beneficial enjoyment of the income for a period commencing 10 years from the date of the transfer (or 15 years where any power of administration specified in paragraph (e) is exercisable solely by the grantor, or spouse living with the grantor and not having a substantial adverse interest, or both, whether or not as trustee). For example, if a trust created on January 1, 1940, provides for the payment of income to the grantor's wife, and the grantor does not reserve any such administrative power but reserves the power to substitute other beneficiaries in lieu of his wife on or after January 1, 1950, the grantor is not taxable on the trust income for the period prior to January 1, 1950. But the income will be attributable to the grantor for the period beginning on such date unless the power is relinquished. If the beginning of such period is postponed, such postponement is considered a new transfer in trust

commencing with the date on which the postponement is effected and terminating with the date prescribed by the postponement. But income for any period shall not be taxable to the grantor by reason of the preceding sentence if such income would not be taxable to him in the absence of such postponement. Where the income affected by the power is for a period beginning by reason of some event other than the expiration of a specific term of years, the grantor will be taxable if such event is the practical equivalent of the expiration of a period less than 10 or 15 years, as the case may be, in accordance with the criteria stated in paragraph (c).

The foregoing provisions of this paragraph shall not apply to any one or more of the following powers:

- (1) a power exercisable only by will, other than a power in the grantor to appoint the income of the trust where the income is accumulated for such disposition by the grantor, or may be so accumulated in the discretion of the grantor, or any person not having a substantial adverse interest in the disposition of such income, or both. For example, if a trust provides that the income is to be accumulated during the grantor's life and that the grantor may appoint the accumulated income by will, the grantor is taxable on the trust income;
- (2) a power to determine the beneficial enjoyment of the corpus or the income therefrom if such corpus or income, as the case may be, is irrevocably payable for the purposes and in the manner specified in Section 23 (o);
- (3) If (i) the power is exercisable by a trustee or trustees, none of whom is the grantor, spouse living with the grantor, or a related or subordinate trustee of the type and under all the conditions referred to in subparagraph (4) (ii), and (ii) the exercise of

the power is not subject to the approval or consent of any person other than such trustee or trustees, this paragraph shall not apply to a power—

(A) to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries,

(B) to pay out corpus to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries).

The powers herein described include all the powers described in subparagraph (4), since the latter powers are more limited than those herein described.

(4) If the power—

(i) is exercisable by the grantor or spouse living with the grantor, or both, whether or not as trustee, or

(ii) is exercisable (A) solely by a trustee or trustees who include the father, mother, issue, brother, sister or employee of the grantor, or a subordinate employee of a corporation in which the grantor is an executive or in which the stock holdings of the grantor and the trust are significant from the viewpoint of voting control, and (B) in a manner which may affect the interests of beneficiaries which include the spouse or any child of the grantor (see subparagraph (3) for a power exercisable by a related or subordinate trustee of the class hereinabove described where the exercise of the power does not affect the interest of the spouse or a child of a grantor or where the power is exercisable only with the concurrence of an unrelated and nonsubordinate trustee), or

(iii) is exercisable by any person or persons other than as trustee, or

(iv) is exercisable by any trustee or trustees, and the exercise of the power is subject to the approval

or consent of any person or persons (other than such trustee or trustees), or of the grantor or spouse living with the grantor, or both, in the capacity of trustee,

this paragraph shall not apply—

(aa) to a power to pay out corpus to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries), provided that the power is limited by a reasonable definite external standard. Such standard must be set forth in the trust instrument and must consist of needs and circumstances of the beneficiaries;

(bb) if the power is not limited by a reasonably definite external standard, to a power to pay out corpus to or for any current income beneficiary, provided that any such payment of corpus must be chargeable against the proportionate share of corpus held in trust for the payment of income to such a beneficiary as if such corpus constitutes a separate trust;

(cc) to a power to distribute or apply income to or for any current income beneficiary or to accumulate such income for him, provided that any accumulated income must ultimately be payable to the beneficiary from whom distribution or application is withheld, to his estate, or to his appointees (or persons named as alternate takers in default of appointment) provided that such beneficiary possesses a power of appointment which does not exclude from the class of possible appointees any person other than the beneficiary, his estate, his creditors or the creditors of his estate; or, if payable upon the termination of the trust or in conjunction with a distribution of corpus which distribution is augmented by such accumulated income, is ultimately payable to the current income beneficiaries in shares which have been irrevocably specified in the trust instrument. Accumulated income shall be considered so payable

although it is provided that if any beneficiary does not survive a date of distribution which may reasonably be expected to occur within the beneficiary's lifetime, the share of such deceased beneficiary is to be paid to such persons as the beneficiary may appoint, or is to be paid to one or more designated alternate takers (other than the grantor or the grantor's estate) if the share of such alternate taker or the shares of such alternate takers have been irrevocably specified in the trust instrument;

(dd) to a power, exercisable during (1) the existence of a legal disability of any current income beneficiary, or (2) the period in which any income beneficiary shall be under the age of 21 years, to distribute or apply income to or for such beneficiary or to accumulate and add such income to corpus;

(ee) in a case falling under subdivision (ii) hereof, to a power to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries, whether or not the conditions in subdivision (cc) or (dd) are satisfied, provided that such power is limited by a reasonably definite external standard. For the requirements of such standard, see subdivision (aa) hereof.

A power does not fall within the powers described in subparagraphs (3) and (4) if the trustee is enabled to add to the class of beneficiaries designated to receive the income or corpus, except in so far as provision may be made for after-born or after-adopted children. A mere power to allocate receipts as between corpus and income, even though expressed in broad language, is not deemed a power over beneficial enjoyment with respect to income or corpus.

(e) *Administrative control.*—Income of a trust, whatever its duration, is taxable to the grantor where, under the terms of the trust or the circumstances attendant on its operation, administrative

control is exercisable primarily for the benefit of the grantor rather than the beneficiaries of the trust. Administrative control is exercisable primarily for the benefit of the grantor where—

- (1) a power exercisable by the grantor, or any person not having a substantial adverse interest in its exercise, or both, whether or not in the capacity of trustee, enables the grantor or any person to purchase, exchange or otherwise deal with or dispose of the corpus or the income therefrom for less than an adequate and full consideration in money or money's worth; or
- (2) a power exercisable by the grantor, or any person not having a substantial adverse interest in its exercise, or both, whether or not in the capacity of trustee, enables the grantor to borrow the corpus or income directly or indirectly, without adequate interest in any case, or without adequate security except where a trustee (other than the grantor or spouse living with the grantor) is authorized under a general lending power to make loans without security to the grantor and other persons and corporations upon the same terms and conditions; or
- (3) the grantor has directly or indirectly borrowed the corpus or income and has not completely repaid the loan, including any interest, before the beginning of the taxable year; or
- (4) any one of the following powers of administration over the trust corpus or income is exercisable in a nonfiduciary capacity by the grantor, or any person not having a substantial adverse interest in its exercise, or both; a power to vote or direct the voting of stock or other securities, a power to control the investment of the trust funds either by directing investments or reinvestments or by vetoing proposed investments or reinvestments, and a power to reacquire the trust corpus by substituting other property of an equivalent value.

If a power is exercisable by a person as trustee, it is presumed that the power is exercisable in a fiduciary capacity primarily in the interests of the beneficiaries. Such presumption may be rebutted only by clear and convincing proof that the power is not exercisable primarily in the interests of the beneficiaries. If a power is not exercisable by a person as trustee, the determination of whether such power is exercisable in a fiduciary or a nonfiduciary capacity depends on all the terms of the trust and the circumstances surrounding its creation and administration. For example, where the trust corpus consists of diversified stocks or securities of corporations the stock of which is not closely held and in which the holdings of the trust, either by themselves or in conjunction with the holdings of the grantor, are of no significance from the viewpoint of voting control, a power with respect to such stocks or securities held by a person who is not a trustee will be regarded as exercisable in a fiduciary capacity primarily in the interests of the beneficiaries. Where the trust corpus consists of stock or securities of a closely-held corporation, such a power may or may not, depending upon all the facts, be considered exercisable in a fiduciary capacity.

The mere fact that a power exercisable by the trustee is described in broad language does not indicate that the trustee is authorized to purchase, exchange, or otherwise deal with or dispose of the trust property or income for less than an adequate and full consideration in money or money's worth, or is authorized to lend the trust property or income to the grantor without adequate interest. On the other hand, such authority may be indicated by the actual administration of the trust.

(f) *Limitations of section.* — Despite the limitations of this section, the grantor of a trust directing the payment or application of the income therefrom in satisfaction of the grantor's legal obligations

shall continue to be taxable on the income. The grantor may also be taxable on the income of a trust on the ground that such income is attributable to him in a capacity unrelated to dominion and control over the trust as such as defined in subsections (c), (d), and (e) of this section. Thus, the provisions of this section do not affect the principles governing the taxability of future income to the assignor thereof whether or not the assignment is by means of a trust. Nor, for example, do the provisions of this section affect the applicability of Section 22 (a) to the creator of a family partnership. See further Sections 166 and 167.

Section 22 (a) shall be applied in the determination of the taxability of trust income for taxable years beginning prior to January 1, 1946, without reference to this section.

**CHILDREN'S TRUSTS**

1. The grantor shall have the power at any time during his lifetime, by an instrument in writing delivered to the trustees, to modify, alter, change or amend this agreement in whole or in part, but not in such manner as to bring about a revocation of this agreement or to change or impair the right of enjoyment of any beneficiary, and provided, further, that grantor shall not have the power at any time during the continuance of the trusts hereof to revest in himself title to any part of the corpus or income of the trust hereby created. (1936 Amendment.)

2. The trust hereby created shall be for the use and benefit of grantor's son, Raphael August Shapero. The net income of the trust estate shall, during the minority of grantor's said son, be accumulated and added to the corpus of the trust with power in the trustees to apply out of such accumulations or the corpus a suitable sum from time to time for the maintenance and education of such minor if such minor by reason of the death or incapacity of the grantor or of other cause whatsoever shall have no other sufficient means therefor and with power in the individual trustee during his lifetime to direct the paying out of any such accruing or accumulated income for the benefit of such minor in any way which the grantor as parent of said minor is not under obligation in law to provide. From and after the time grantor's said son, Raphael August Shapero, shall arrive at the age of twenty-one (21) years, the trustees shall pay to him the entire net income from the trust estate during the continuance thereof, unless the individual trustee during his lifetime, or the successor individual trustee, as the case may be, shall

otherwise direct; *Provided, However,* that in no event shall the grantor, either as an individual or trustee hereunder, be entitled to receive any of the income or the accumulations thereof derived from the trust estate created herein. (1936 Amendment.)

3. The trustees shall assign, transfer, convey and pay over to grantor's son, Raphael August Shapero, one-seventh (1/7) of the residue and remainder of the trust property and estate as and when he shall arrive at the age of thirty (30) years, and one-third (1/3) of the balance thereof as and when he shall arrive at the age of thirty-five (35) years, and one-half (½) of the balance thereof as and when he shall arrive at the age of forty (40) years, and all of the rest, residue and remainder thereof as and when he shall arrive at the age of forty-five (45) years, free and discharged from the trusts hereof.

4. If grantor's son, Raphael August Shapero, shall die before he shall be entitled to receive the entire body or corpus of the trust property and estate, leaving issue surviving him, all of the rest, residue and remainder of the trust property and estate so held in trust for him, shall be assigned, transferred, conveyed and paid over to his issue by right of representation at the following times and in the following manner, viz: That part or portion of the trust property and estate going to such of said issue who are then of full age, shall be forthwith assigned, transferred, conveyed and paid over to him or her, free and discharged from the trusts hereof; and as to the part or portion of the trust estate going to any of such issue who are then under the age of twenty-one (21) years, the same shall continue in trust for the purpose of the accumulation of the rents, profits and income thereof for the use and

benefit of such minor issue until each of said issue at any time surviving shall arrive at the age of twenty-one (21) years, with power in the individual trustee to apply, out of such rents, profits and income, a suitable sum from time to time for the maintenance and education of such minors if they shall have no other sufficient means therefor, and as and when each of said minor issue shall arrive at the age of twenty-one (21) years, that part or portion of the trust estate going to such issue, together with the accumulations thereof held for him or her, shall be assigned, transferred, conveyed and paid over to him or her, free and discharged from the trusts hereof; but if any of such issue shall have died before attaining the age of twenty-one (21) years, that part or portion of the trust estate so held for such deceased issue, together with the accumulations thereof held for him or her, shall be assigned, transferred, conveyed and paid over to his or her issue by right of representation, if any there shall be, and if none, then share and share alike to his or her brothers and sisters and the issue by right of representation of any deceased one of them, or if none, then share and share alike to grantor's other children and/or to the issue by right of representation of any deceased one of them.

5. If grantor's son, Raphael August Shapero, shall die before he shall be entitled to receive the entire body or corpus of the trust estate, leaving no issue surviving him, then the trustees shall set aside equal parts of the said trust property and estate which shall be of equal value and income production, in separate trusts, one for each child of grantor who shall then be living, and one for the issue by right of representation of each child of grantor who shall have died before that time leaving issue then surviving; and the trustees shall keep a separate book ac-

count concerning each of said trust estates or allocated parts and the respective beneficiaries thereof, in such manner as to show that each of said trust estates has been definitely allocated to the respective beneficiaries thereof. As to any property incapable of exact division comprising the trust principals, upon the commencement of said trusts, it shall not be necessary for the trustees to actually physically divide the same into as many parts as there may be trusts, but an undivided part thereof may be deemed and shall be duly evidenced by appropriate book entries to have been definitely allocated to each several trust.

(a) The net income of the trust property and estate so directed to be set aside and held for any child of grantor shall, during the minority of such child, be accumulated and added to the corpus of said trust, with power in the trustees to apply out of such accumulations or the corpus, a suitable sum from time to time for the maintenance and education of such minor if such minor, by reason of the death or incapacity of the grantor or of other cause whatsoever, shall have no other sufficient means therefor, and with power in the individual trustee during his lifetime to direct the paying out of any such accruing or accumulated income for the benefit of such minor in any way which the grantor as parent of said minor is not under obligation in law to provide. From and after the time each of grantor's said children shall arrive at the age of twenty-one (21) years, the trustees shall pay to him or her the entire net income from his or her respective trust estate during the continuance thereof, unless the individual trustee during his lifetime, or the successor individual trustee, as the case may be, shall otherwise direct. *Provided, However,* that in no event shall the grantor, either as an individual or trustee hereunder, be entitled to receive any of the income or

the accumulations thereof derived from such trust estate created herein. (1936 Amendment.)

(b) The trustees shall assign, transfer, convey and pay over to each of grantor's said children, one-seventh (1/7) of the residue and remainder of his or her respective trust estate as and when he or she shall arrive at the age of thirty (30) years, and one-third (1/3) of the balance thereof as and when he or she shall arrive at the age of thirty-five (35) years, and one-half (½) of the balance thereof as and when he or she shall arrive at the age of forty (40) years, and all of the rest, residue and remainder thereof as and when he or she shall arrive at the age of forty-five (45) years, free and discharged from the trusts hereof.

(c) If any of grantor's said children shall die before he or she shall be entitled to receive the entire body or corpus of the trust property and estate so directed in paragraph 5 hereof to be set aside and held in trust for him or her, leaving issue surviving him or her, all of the rest, residue and remainder of said trust property and estate so held in trust for such deceased child of grantor, shall be assigned, transferred, conveyed and paid over to his or her issue by right of representation at the same times and in the same manner as hereinbefore provided in paragraph 4 hereof for the payment and disbursement to the issue of grantor's son, Raphael August Shapero.

(d) If any of grantor's said children shall die before he or she shall be entitled to receive the entire body or corpus of the trust property and estate so directed to be set aside and held in trust for him or her, leaving no issue surviving him or her, then, under any such circumstances, all of the property embraced within the trust so held for

such deceased child of grantor, shall be equally divided among and added to the trusts herein created for the benefit of grantor's other children and/or to the trusts created for the issue by right of representation of any deceased child of grantor, as the case may be; and if any of such trusts shall have expired through the passage of time, then the share which would have been added to such expired trust shall pass to the beneficiary thereof. The portion thus added to any such existing trust shall constitute principal thereof and the trust conditions applicable shall govern the disposition of the principal and income.

14. The individual trustee during his lifetime, and thereafter the successor individual trustee, notwithstanding anything hereinbefore contained to the contrary, shall have full, complete and absolute power and authority to direct the payment and conveyance, forthwith or otherwise, of any part or all of the principal of the trust property and estate, as well as any accumulated income therefrom, to the then living beneficiary or beneficiaries thereof, in such proportions as the individual trustee or the successor individual trustee may think proper.

**WIFE'S TRUST**

2. After paying the necessary expenses of the management and preservation of the trust property and estate, the trustees shall disburse the entire net income therefrom to grantor's wife, Ruth Bernstein Shapero, at such times and in such amounts as the individual trustee shall direct during his lifetime, and after his death as the successor individual trustee shall direct, and after the death of the successor individual trustee, then as grantor's wife, Ruth Bernstein Shapero, shall direct, unless she shall remarry, and if she shall remarry, then at the time of her remarriage, all power in her to direct the payment or use of said net income shall immediately cease and determine, and thereafter said net income shall be paid out, used and expended as hereinafter provided. Any income from the trust property and estate which has not been disbursed as herein provided shall be accumulated and retained as cash, or invested and distributed at a later date in the discretion of the individual trustee. Provided, however, that in no event shall the grantor, either as an individual or trustee hereunder, at any time be entitled to receive any of the income or the accumulations thereof derived from the trust estate created herein.

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(1)

THE END

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1947

No. 779

NATE S. SHAPERO, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED  
STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH  
CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The prevailing (R. 16-44) and dissenting (R. 45-48) opinions in the Tax Court are reported in 8 T. C. 104. The opinion of the Circuit Court of Appeals (R. 99-109) is reported in 165 F. 2d 811.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 3, 1948 (R. 98). The petition for a writ of certiorari was filed on May 1, 1948. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

**QUESTION PRESENTED**

Whether the taxpayer, as grantor of three trusts for the benefit of his wife and two children, respectively, is taxable on the income therefrom under Section 22 (a) of the Internal Revenue Code and Section 29.22 (a)-21 (e) of Treasury Regulations 111, as amended.

**STATUTE AND REGULATIONS INVOLVED**

These are set out in the Appendix, *infra*, pp. 17-22.

**STATEMENT**

The Tax Court found the following facts (R. 17-29) :

The taxpayer is an individual residing at Detroit, Michigan. His returns for the years in controversy were prepared on the cash basis and were filed with the Collector of Internal Revenue for the District of Michigan (R. 17).

In 1918, taxpayer founded the Economical Drug Company. This business was operated by him for a time as a sole proprietorship and was later incorporated, with the taxpayer becoming president of the corporation. In 1931, Economical Drug Company was consolidated with Cunningham Drug Company under the name Economical-Cunningham Drug Stores, Inc. The name was later changed to Cunningham Drug Stores, Inc. The corporation will hereinafter be referred to as Cunningham. The taxpayer has always been

president and a director of Cunningham. Salaries and other compensation for personal services received by taxpayer in the calendar years 1940 and 1941 were reported by him on his tax returns as \$44,999.92 and \$59,999.92, respectively. The stock of Cunningham was listed on the Detroit and Chicago Stock Exchanges throughout the tax years here in question. (R. 17-18.)

The taxpayer's family consists of his wife, Ruth Bernstein Shapero, a son, Raphael August, born in 1926, and a daughter, Marianne, born October 1, 1930 (R. 18).

Under date of December 6, 1934, by separate instruments, the taxpayer created three trusts, one each for the benefit of his wife, his son and his daughter. Each trust was amended by a separate instrument under date of December 29, 1936. In each trust, the taxpayer was named as "individual Trustee" and Detroit Trust Company as "corporate Trustee." (R. 18.)

The trusts for the benefit of the taxpayer's children were identical. Paragraph 2 of the children's trusts, as typified by the trust for the benefit of the taxpayer's son, provided in part as follows (R. 18-19):

2. The trust hereby created shall be for the use and benefit of Grantor's son, **RAPHAEL AUGUST SHAPERO**. The net income of the trust estate shall, during the minority of Grantor's said son, be accumulated and added to the corpus of the

trust with power in the Trustees to apply out of such accumulations or the corpus a suitable sum from time to time for the maintenance and education of such minor if such minor by reason of the death or incapacity of the Grantor or of other cause whatsoever shall have no other sufficient means therefor and with power in the individual trustee during his lifetime to direct the paying out of any such accruing or accumulated income for the benefit of such minor in any way which the Grantor as parent of said minor is not under obligation in law to provide. From and after the time Grantor's said son, **RAPHAEL AUGUST SHAPERO**, shall arrive at the age of twenty-one (21) years, the Trustee shall pay to him the entire net income from the trust estate during the continuance thereof, unless the individual trustee during his lifetime, or the successor individual trustee, as the case may be, shall otherwise direct; *Provided, However,* that in no event shall the Grantor, either as an individual or Trustee hereunder, be entitled to receive any of the income or the accumulations thereof derived from the trust estate created herein.

The trustees were directed to distribute the trust corpus to the beneficiary in varying amounts, beginning when he or she reached the age of thirty and ending when the beneficiary reached the age of forty-five, at which time all the rest, residue and remainder of the trust

estate was to be paid over to the beneficiary, free and discharged from the trust. In the event any beneficiary died before becoming entitled to receive the trust corpus, provisions were made in favor of the beneficiary's issue or, if none, for the taxpayer's other children and their issue. (R. 19.)

The trust for the benefit of the taxpayer's wife provided that after paying necessary expenses, the trustees should distribute the entire net income therefrom to the beneficiary at such times and in such amounts as the individual trustee (taxpayer) should direct during his lifetime and after his death as the successor individual trustee should direct, and after the death of such successor individual trustee, as the beneficiary should direct, unless and until she should remarry, at which time her power to direct the payment or use of the net income should cease and determine. Any income not disbursed was to be accumulated and retained as cash or invested and distributed at a later date, in the discretion of the individual trustee. In the event the taxpayer's wife should remarry after his death, the trustees were directed to set aside one-third of the then corpus of the trust estate in a separate trust for her use and benefit and to hold the remaining two-thirds in equal shares for the benefit of the taxpayer's children, to be administered in the same manner as that provided in the trusts for their benefit. Upon the death of the taxpayer's wife, the entire

corpus of the trust was to be held in equal shares for the benefit of the taxpayer's children as aforesaid. (R. 20.)

Provision was made in each of the trusts for invasion of the corpus upon direction by the individual trustee or his successor if, in the opinion of the individual trustee, or his successor, the income of the trust was insufficient to support and maintain the grantor's wife and to furnish her with funds for reasonable travel and recreation, or if it was insufficient to support, maintain and educate the grantor's children, including a college, university or finishing school education, or in case of any emergency befalling any beneficiary, such as illness, accident, or extraordinary financial distress. It was provided, however, that during the lifetime of the grantor no part of such principal should ever be used to satisfy any legal obligation of the grantor toward such beneficiary or to relieve the grantor therefrom. (R. 20-21.)

Material provisions, common to all the trusts, as typified by those in the Ruth Bernstein Shapero trust, may be summarized as follows (R. 21-27):

The grantor was given the power to modify, alter or amend the agreement in whole or in part so long as the change did not work a revocation, change or impair the right of enjoyment of any beneficiary, or revest in the grantor title to any part of the corpus or income (R. 21). The text of this provision is quoted *infra*, pp. 12-13. The trustees were authorized to retain any property,

whether or not it constituted a legal investment (R. 22-23), and to dispose of all property "upon such terms as in the absolute and uncontrolled discretion of the individual Trustee, or the successor individual Trustee as the case may be, shall deem expedient and proper" (R. 23). After specifically granting to the individual trustee or his successor the powers to designate forms of investment of trust assets, to direct sales and fix prices of any trust property, to distribute in kind to the persons entitled to participate any stocks, bonds, or other securities in the trust estate at a price to be fixed by the individual trustee, or his successor, all in his "sole and uncontrolled judgment and discretion" (R. 23-24), the trust instrument recited that (R. 25):

(j) It is Grantor's intention to give the individual Trustee during his lifetime, and after his death to the successor individual Trustee, the fullest and most complete powers and authority which it is possible for Grantor to give in respect of all sales, investments, expenditures, management and control of the trust property and estate; provided, always that no power herein given to the individual Trustee shall ever be interpreted or construed as a power giving the Grantor the right to revest in himself title to any of the trust property and estate or the income produced therefrom.

In addition, the individual trustee or his successor was granted authority, at any time, to direct the payment of corpus or accumulated income to the then living beneficiary or beneficiaries in such proportions as he may think proper (R. 26), and to remove the corporate trustee, fill the vacancy or leave the vacancy unfilled (R. 26-27).

The original corpus of the Ruth Bernstein Shapero trust consisted of 20,000 shares of the stock of Cunningham. The original corpus of each of the other two trusts consisted of 672 shares of Cunningham stock. In 1937, 10,300 shares of Cunningham stock were sold from the Ruth Bernstein Shapero trust and the proceeds were invested in other stocks and securities. The other 9,700 shares are still held in the trust. The taxpayer from time to time contributed additional shares of the stock of Cunningham to the children's trusts, the last such contribution being in 1938. A purchase was also made by the children's trusts of shares of Ray Mar Corporation, the assets of which consisted wholly of Cunningham shares. Throughout the years here in controversy each of the children's trusts held 7,092 shares of Cunningham, as well as other stocks and securities. (R. 27.)

During 1940 to 1941, there were 190,798 shares of stock of Cunningham outstanding. In 1940, 104,279 shares were voted and in 1941, 104,660 shares were voted. Of the amounts so voted the percentage of shares voted by the Shapero inter-

ests, including the amounts held in the trusts, was 60.64 percent in 1940 and 59.85 percent in 1941. (R. 27-28.)

All shares of stock and other registered securities in the trusts were held in the name of "Nate S. Shapero & Detroit Trust Company, Trustees u/a, dated December 6, 1934, for the benefit of [name of beneficiary]." All securities were held in the physical possession of the corporate trustee. The funds of the trust are carried by the corporate trustee in its general fiduciary account for all trusts administered by it. The shares of Cunningham stock held in the trusts were voted by an officer of the corporate trustee at the stockholders' meetings of Cunningham in each of the years 1936 to 1941, both inclusive, under proxies granted by the trustees. In making sales of securities and in making investments, such transactions have, in most cases, been passed upon by the investment committee of the corporate trustee, as well as by the taxpayer as individual trustee. Such transactions were usually originated by some officer or employee of the corporate trustee. No loan of cash or securities has ever been made out of any of the trusts to or for the account of the taxpayer, nor has he ever requested such a loan. (R. 28.)

Of the net income for 1940 from the trust for the benefit of the taxpayer's wife, the sum of \$1,767.15 was distributed to her in that year. Of the income for 1941, \$1,767.15 was distributed to

her in that year. None of the income of the children's trusts has been distributed but all has been retained and invested. (R. 28.)

Returns were filed for the years in question by the taxpayer, his wife, and each of the three trusts. The taxes shown to be due thereon were paid. In his individual returns for 1940 and 1941, the taxpayer reported net income in the respective amounts of \$88,401.76 and \$97,865.87. (R. 29.)

Net incomes taxable to the fiduciary were reported as follows by the three trusts (R. 29):

	1940	1941
Trust for wife.....	\$13,031.13	\$14,345.14
Trust for son.....	7,115.25	8,985.00
Trust for daughter.....	7,140.28	8,011.70

In October 1944, consents, signed respectively by the taxpayer as grantor, and by the trustees, were filed with the respondent in conformity with the requirements of Section 134 (b) (2) of the Revenue Act of 1943 (R. 29).

The Commissioner taxed to the grantor the income of the three trusts for the years 1940 and 1941 (R. 9, 11, 17) and the Tax Court held such action correct (R. 44). The Circuit Court of Appeals affirmed (R. 109).

#### **ARGUMENT**

Both of the courts below held, correctly, we submit, that the taxpayer is accountable under Section 22 (a) of the Internal Revenue Code

(Appendix, *infra*, p. 17) and *Helvering v. Clifford*, 309 U. S. 331, for the income of the three trusts that he created for the benefit of his wife and two children, respectively.

The Tax Court based its decision upon the conclusion (R. 44) that the rights retained by taxpayer and the benefits enjoyable by him were such that there was no substantial change in his economic position as a result of the transfers in trust, and, hence, that the case is within the purview of the *Clifford* doctrine. The Tax Court thought it unnecessary to consider the regulations (R. 44) and reached its conclusion without regard to them.

In affirming, the Circuit Court of Appeals said (R. 100) that it thought that the majority opinion in the Tax Court was sound and would affirm on its rationale were it not for the problem as to the application of the new *Clifford* regulations (Sec. 29.22 (a)-21 of Treasury Regulations 111, as amended (Appendix, *infra*, pp. 18-22) which required consideration. The Court of Appeals then proceeded to consider the regulation in the light of the facts presented and concluded, correctly, we submit, that it supports the tax.

1. The new *Clifford* regulation is by its terms applicable only to taxable years beginning after 1945. Consequently, in this case, whatever tax liability there may be must be found in the law as it existed before the new regulation. In this aspect of the case, the Tax Court's opinion is,

we think, plainly correct and, since a case such as this must depend upon its own peculiar facts, no problem worthy of consideration by this Court is presented.

That this is not a case for certiorari is a conclusion rendered no less true by the fact that it is the policy of the Treasury not to assert the tax in years beginning before 1946 with respect to cases not yet finally determined if the new regulation would, if applicable, relieve the taxpayer of liability. See Mim. 6156, 1947-2 Cum. Bull. 13. Moreover, it is clear that in the instant case, as held by the court below, the regulation does not help the taxpayer and he remains accountable for the tax.

The critical provisions of the regulation are found in paragraph (e) and they were the ones relied upon by the Circuit Court of Appeals in sustaining the tax. See Appendix, *infra*, pp. 19-21. These provisions cover cases where under the terms of the trust or the circumstances attendant on its operation, administrative control is exercisable primarily for the benefit of the grantor rather than the beneficiaries of the trust. In the instant case, paragraph 1 of each indenture, as amended, provides as follows (R. 21):

1. The Grantor shall have the power at any time during his lifetime, by an instrument in writing delivered to the Trustees, to modify, alter, change or amend this agreement in whole or in part, but not in

such manner as to bring about a revocation of this agreement or to change or impair the right of enjoyment of any beneficiary, and provided, further, that Grantor shall not have the power at any time during the continuance of the trusts hereof to revest in himself title to any part of the corpus or income of the trust hereby created.

This provision would seem to enable the grantor to vest in himself, individually, any and all types of administrative control over the trusts so long as the rights of enjoyment of the beneficiaries are not altered. It might, for example, permit the grantor to provide that the trust funds should be loaned to him with or without security or interest whenever he should request such a loan. And under paragraph (e) (2) of the new regulation, such an untrammeled power to borrow is considered as a type of administrative control exercisable primarily for the benefit of the grantor. We submit that there is good reason for the provision, and where the grantor can borrow the trust funds at his pleasure and use them for his own purposes, it can make little difference from the tax standpoint that the trust instrument contains no provision for reversion to the grantor and the trust funds are unimpaired.

Moreover, paragraph 1 of the trust instruments, above quoted, has a direct bearing upon the taxpayer's power to vote the shares of stock in the trusts and it should be considered in connection

therewith. Each trust held shares of stock in a corporation of which the taxpayer was the president and a director and principal stockholder, and the stock was listed on the Detroit and Chicago Stock Exchanges. It seems clear that the grantor, fortified by his rights under paragraph 1 of the trust instruments, could have exercised in a non-fiduciary capacity his right to vote the stock placed in trust; and hence the regulation justifies the tax. See paragraph (e) (4), Appendix, *infra*, pp. 20-21. And see *Helvering v. Fuller*, 310 U. S. 69, 72, 76; *Helvering v. Stuart*, 317 U. S. 154, 169; *Commissioner v. Sunnen*, decided April 5, 1948, No. 227, this Term.

Although, as above noted, the Tax Court did not pass on the regulation, it concluded in its opinion (R. 33, 43) that the taxpayer's reserved powers could have been utilized for his own economic benefit. And the Circuit Court of Appeals, applying the regulation, reached a similar conclusion. (R. 107.)

2. In support of his application for certiorari, the taxpayer contends (Pet. 10, 11, 27) that the instant decision is in conflict with the decision of the Second Circuit Court of Appeals in *Cushman v. Commissioner*, 153 F. 2d 510. We submit that no such conflict exists, although it does seem that under the *Dobson* rule (*Dobson v. Commissioner*, 320 U. S. 489), the Circuit Court of Appeals should not have reversed the decision of the Tax Court in the *Cushman* case. That case as well

as the others cited by the taxpayer on page 11 of his petition for certiorari (*United States v. Morss*, 159 F. 2d 142 (C. C. A. 1st); *Welch v. Commissioner*, 8 T. C. 1139) did not deal with the new regulation and are distinguishable from the instant case because the grantors there did not have powers equivalent to those retained by the grantor here authorizing him to amend the trust so as explicitly to permit a non-fiduciary exercise of powers for his own purposes. Moreover, it does not appear in those cases that the grantor's power to vote the trustee shares had as much bearing on his actual control of the company in the taxable years as it had here. Here the Tax Court concluded (R. 42) that "it was through the trusts that petitioner had control of more than 50 per cent of the voted stock." The situation in the instant case is analogous to the one in *Helvering v. Fuller*, *supra*, 310 U. S. 69, 72, 76, where this Court explicitly pointed out that such considerations are of importance in determining taxability under the *Clifford* rule.

It is true that the *Stockstrom* case (*Stockstrom v. Commissioner*, 148 F. 2d 491 (C. C. A. 8th), certiorari denied, 326 U. S. 719, on remand, 7 T. C. 251), referred to by the taxpayer (Pet. 17), was eventually settled so as not to tax to the grantor the income from the seven trusts for the grandchildren, and this adjustment was made in the light of the amended regulation; but that case is distinguishable because there the grantor did not

have administrative control comparable to that of the taxpayer here.

As we have said, the instant decision turns on the construction of the peculiar provisions of the trusts and the circumstances attendant on their operation. Although the Circuit Court of Appeals considered the new regulation and the Tax Court did not, the two decisions are in other respects harmonious and consistent and in the circumstances there is believed to be no adequate basis for further review by this Court.

#### CONCLUSION

The decision is correct; there is no conflict; and the petition should be denied.

Respectfully submitted.

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MAY, 1948.

## APPENDIX

Internal Revenue Code:

### SEC. 22. GROSS INCOME.

(a) *General definition.*—“Gross income” includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

\* \* \* \* \*

(26 U. S. C. 1940 ed., Sec. 22.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.22 (a)-1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be under-

stood to include profit gained through a sale or conversion of capital assets. \* \* \*

\* \* \* \* \*

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.22 (a)-21 [as added by T. D. 5488, 1946-1 Cum. Bull. 19, and amended by T. D. 5567, 1947-2 Cum. Bull. 9]. TRUST INCOME TAXABLE TO THE GRANTOR AS SUBSTANTIAL OWNER THEREOF.—(a) *Introduction.*—Income of a trust is taxable to the grantor under section 22 (a) although not payable to the grantor himself and not to be applied in satisfaction of his legal obligations if he has retained a control of the trust so complete that he is still in practical effect the owner of its income. (*Helvering v. Clifford*, 309 U. S. 331.) In the absence of precise guides supplied by an appropriate regulation, the application of this principle to varying and diversified factual situations has led to considerable uncertainty and confusion. The provisions of this section accordingly resolve the present difficulties of application by defining and specifying those factors which demonstrate the retention by the grantor of such complete control of the trust that he is taxable on the income therefrom under section 22 (a). Such factors are set forth in general in paragraph (b) and in detail in paragraphs (c), (d), and (e), below.

(b) *In general.*—In conformity with the principle stated in paragraph (a) above, the income of a trust is attributable to the grantor (except where such income is taxable to the grantor's spouse or former spouse under section 22 (k) or 171) if—

- (1) the corpus or the income therefrom

will or may return after a relatively short term of years (see paragraph (c));

(2) the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition (other than certain excepted powers), whether by revocation, alteration, or otherwise, exercisable by the grantor, or another person lacking a substantial adverse interest in such disposition, or both (see paragraph (d)); or

(3) the corpus or the income therefrom is subject to administrative control, exercisable primarily for the benefit of the grantor (see paragraph (e)).

\* \* \* \* \*

(e) *Administrative control.*—Income of a trust, whatever its duration, is taxable to the grantor where, under the terms of the trust or the circumstances attendant on its operation, administrative control is exercisable primarily for the benefit of the grantor rather than the beneficiaries of the trust. Administrative control is exercisable primarily for the benefit of the grantor where—

(1) a power exercisable by the grantor, or any person not having a substantial adverse interest in its exercise, or both, whether or not in the capacity of trustee, enables the grantor or any person to purchase, exchange or otherwise deal with or dispose of the corpus or the income therefrom for less than an adequate and full consideration in money or money's worth; or

(2) a power exercisable by the grantor, or any person not having a substantial adverse interest in its exercise, or both, whether or not in the capacity of trustee, enables the

grantor to borrow the corpus or income, directly or indirectly, without adequate interest in any case, or without adequate security except where a trustee (other than the grantor or spouse living with the grantor) is authorized under a general lending power to make loans without security to the grantor and other persons and corporations upon the same terms and conditions; or

(3) the grantor has directly or indirectly borrowed the corpus or income and has not completely repaid the loan, including any interest, before the beginning of the taxable year; or

(4) any one of the following powers of administration over the trust corpus or income is exercisable in a nonfiduciary capacity by the grantor, or any person not having a substantial adverse interest in its exercise, or both: a power to vote or direct the voting of stock or other securities, a power to control the investment of the trust funds either by directing investments or reinvestments or by vetoing proposed investments or reinvestments, and a power to reacquire the trust corpus by substituting other property of an equivalent value.

If a power is exercisable by a person as trustee, it is presumed that the power is exercisable in a fiduciary capacity primarily in the interests of the beneficiaries. Such presumption may be rebutted only by clear and convincing proof that the power is not exercisable primarily in the interests of the beneficiaries. If a power is not exercisable by a person as trustee, the determination of whether such power is exercisable in a fiduciary or a nonfiduciary capacity depends on all the terms of

the trust and the circumstances surrounding its creation and administration. For example, where the trust corpus consists of diversified stocks or securities of corporations the stock of which is not closely held and in which the holdings of the trust, either by themselves or in conjunction with the holdings of the grantor, are of no significance from the viewpoint of voting control, a power with respect to such stocks or securities held by a person who is not a trustee will be regarded as exercisable in a fiduciary capacity primarily in the interests of the beneficiaries. Where the trust corpus consists of stock or securities of a closely held corporation, such a power may or may not, depending upon all the facts, be considered exercisable in a fiduciary capacity.

The mere fact that a power exercisable by the trustee is described in broad language does not indicate that the trustee is authorized to purchase, exchange, or otherwise deal with or dispose of the trust property or income for less than an adequate and full consideration in money or money's worth, or is authorized to lend the trust property or income to the grantor without adequate interest. On the other hand, such authority may be indicated by the actual administration of the trust.

(f) *Limitations of section.*—Despite the limitations of this section, the grantor of a trust directing the payment or application of the income therefrom in satisfaction of the grantor's legal obligations shall continue to be taxable on the income. The grantor may also be taxable on the income of a trust on the ground that such income is attributable to him in a capacity unrelated to dominion and control over the

trust as such as defined in subsections (c), (d), and (e) of this section. Thus, the provisions of this section do not affect the principles governing the taxability of future income to the assignor thereof whether or not the assignment is by means of a trust. Nor, for example, do the provisions of this section affect the applicability of section 22 (a) to the creator of a family partnership. See further sections 166 and 167.

Section 22 (a) shall be applied in the determination of the taxability of trust income for taxable years beginning prior to January 1, 1946, without reference to this section.

